CAPITAL INVESTMENT COUNSEL

The Columns

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Something interesting is brewing. Sure, the Fed talks tough, and rates are rising – nothing new there. The surprise is that stocks are generally going higher. The 10-year US Treasury yield jumped from 3.5% on September 30 to 4.1% this week. Conventional wisdom says that's a death knell for the market. The market's response has been impressive and has a little "hold my beer and watch this" vibe as stocks rallied 7% month to date. Remember it's the market's reaction to the news and not the news itself that matters. Maybe just maybe the market is looking ahead to 2023 and thinks the damage from higher rates may be done.

The timing could not be better as we're entering a potential hall of fame for market seasonality: the last 50 trading days of the year combined with a potential post mid-term election rally. The last 50 days can have a positive bias. Over the last 42 years, stocks are higher 77% of the time with a median gain of 3.3%. (Source: S&P) The good news is the market doesn't have to be doing well going into the last 50 days to see a turn higher. In fact, the potential return is higher if the market is negative going into this stretch: a median gain of 4.1% versus 3.3% for a positive year to date market. Either way, the odds say this bull run may continue.

Earnings reports are almost done, and after the selloff, the market's more reasonable valuation helps investors see the positives. Quarterly results were decent and that gives stocks room to run. We feel inflation peaked in June and will continue to trend lower. The recent BAML investor survey shows record levels of cash held among portfolio managers and an eye popping 49% are underweight stocks. That's a big number and smells like capitulation to me. If the market continues to improve, these managers may be scrambling to buy and potentially provide the fuel for a strong November.

The Presidential elections get the headlines, but the mid-terms are my first love. The September market action was uncomfortable. I've seen volatile markets over the years, but the modern variations "feel" worse. It's the sheer speed of the declines that grab me.

The market recently retested the summer lows on October 12th and it's a positive test so far. The market seems to be transitioning to the well-worn mid-term script. We've compiled a comprehensive midterm database that looks back to 1950 and uses the last 18 midterm elections. We use a date range of October 1 through November 19. That six-week period captures the election timeline without getting into the positive bias of the Thanksgiving week data.

As tough as our 2022 selloff has been, it wasn't unexpected, as the market tends to swing wildly during mid-terms. Since 1950, the change from the low price of the period to the high has averaged 11%. For 2022, the swing has measured 27%, so you're not alone in thinking this feels worse than usual.

History shows that we may have a positive push to end 2022. In the previous 18 mid-terms, there were 15 positives and only 3 negatives. The negatives were 1970, 1978 and 2018. Those 15 positives showed an average gain of 3%. Mid-terms see their share of selloffs, but the downdrafts potentially set the market up for longer-term success. I'm keeping my eye on the prize of where we might be in November 2023.

Looking at the twelve months following the election day itself, we find the market higher 18 out of 18 times. The S&P 500 hasn't dropped in the 12 months *after* a midterm election pullback since 1946. It has averaged a 32% rally once the correction hit bottom. At what level do we find the bottom? Based on the action of this week, it feels like we may be getting close. If you have any comments, feel free to contact me at heddins@capital-invest.com or call me at 919-656-0836.

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